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EXCEPTION

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## --- JRE THE ARIZONA CORPORATION COMMISSION

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2001 FEB 12 P 1:51

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IN THE MATTER OF THE APPLICATION  
OF U S WEST COMMUNICATIONS, INC.,  
A COLORADO CORPORATION, FOR A  
HEARING TO DETERMINE THE  
EARNINGS OF THE COMPANY, THE  
FAIR VALUE OF THE COMPANY FOR  
RATEMAKING PURPOSES, TO FIX A  
JUST AND REASONABLE RATE OF  
RETURN THEREON AND TO APPROVE  
RATE SCHEDULES DESIGNED TO  
DEVELOP SUCH RETURN.

Docket No. T-01051B-99-0105

Arizona Corporation Commission  
**DOCKETED**

FEB 12 2001

DOCKETED BY

**RUCO'S EXCEPTIONS**

The Residential Utility Consumer Office ("RUCO") believes that that structure of the Price Cap Plan, as modified by the Administrative Law Judge's Recommended Opinion and Order ("RO&O"), is a reasonable attempt to limit the unforeseen consequences of regulating Qwest under performance-based regulation. Nevertheless, RUCO continues to object to the level at which revenues are set under that Price Cap Plan.

**STARTING POINT OF PRICE CAP PLAN IS INFLATED**

The RO&O approves a revenue increase of nearly \$43 million as a starting point for the Price Cap Plan. To determine whether a \$43 million rate increase is necessary, the Commission must examine Qwest's costs of service. However, the Commission has not fully

1 examined the Company's cost of service. The Commission's analysis of the Company's cost  
2 of service is obscured by two issues.

3 First, the record provides no clear connection between Qwest's cost of service and the  
4 \$43 million rate increase. Prior to reaching settlement, Staff made a number of accounting  
5 adjustments to Qwest's application, and concluded that a rate increase of approximately \$7  
6 million would be appropriate. Staff explained at the hearing on the settlement that it arrived at  
7 a \$43 million rate increase by adjusting its \$7 million proposal upward, to reflect only one-half  
8 of several of Staff's adjustments. Staff's discounting of several of its adjustments apparently  
9 reflected its assessment of the risk that Qwest might successfully win the entire \$201 million  
10 rate increase it sought. However, Qwest and Staff also testified that the \$43 million rate  
11 increase was a negotiated number, not attributable to any particular resolution of individual  
12 issues. Without a clear understanding of the costs Qwest incurs to provide service, the  
13 Commission can make no determination that the \$43 million rate increase is just and  
14 reasonable.

15 Second, the Commission's depreciation decision further muddies the determination of  
16 whether the rates under the Price Cap Plan are just and reasonable. The Commission  
17 recently established new depreciation rates for Qwest, reflecting its expectation that Qwest's  
18 copper cable plant will soon become obsolete. The new depreciation rates increased the  
19 Company's depreciation expense in its rate application by approximately \$100 million per year.  
20 Exh. Qwest-20, pg. 2 [Wu]. In its initial testimony in this proceeding, Staff proposed a  
21 "modernization credit" to provide refund to customers if Qwest failed to retire plant at the pace  
22 implicit in the new depreciation rates.<sup>1</sup> Exh. S-10 at pgs. 8-9.

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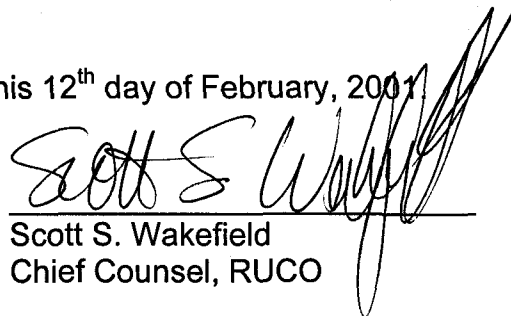
23 <sup>1</sup> Qwest's plans for plant retirements are only a fraction of the retirements assumed by the newly-approved  
24 depreciation rates (Exh. S-10 at pg. 7, lines 11-18 [Dunkel]). In recent years, Qwest has been retiring 2-4 percent  
of its Arizona investment per year. The new depreciation rates approved by the Commission assume that Qwest  
will be retiring over 13 percent of its investment per year. (Exhibit S-10 at pg. 5, lines 3-5 [Dunkel]).

1 The RO&O abdicates the Commission's duty to ensure that Qwest's rates under the  
2 Price Cap Plan will be just and reasonable. By adopting the Price Cap Plan for its 3 year initial  
3 period, with possible renewals, the Commission agrees not to re-examine the reasonableness  
4 of Qwest's rates while the Plan is in effect. At the same time, the Price Cap Plan explicitly  
5 eliminates Staff's proposed "modernization credit." Price Cap Plan, section 4, page 6.  
6 Instead, the Price Cap Plan provides that the Commission will merely monitor Qwest's capital  
7 investment during the initial three-year term of the Plan. The Price Cap Plan contains no  
8 protection against Qwest collecting an additional \$100 million per year based upon rapid  
9 depreciation rates, while at the same time continuing to make retirements at its previous pace.  
10 Absent the protection of the modernization credit or a similar mechanism, the Commission can  
11 have no assurance that the rates established going into the Price Cap Plan will continue to be  
12 just and reasonable throughout the duration of the plan.

13  
14 **CONCLUSION**

15 The Commission should reject the Settlement Agreement at this time until it is able to  
16 determine that a \$43 million rate increase will result in just and reasonable rates. The  
17 Commission could expedite resolution of Qwest's rate application by examining the Company's  
18 complete cost of service picture, including its depreciation practices. RUCO would not object  
19 to using the currently filed 1999 test year data for that inquiry. That investigation should yield  
20 sufficient information for the Commission to determine the appropriate revenue requirement at  
21 which to begin a flexible pricing plan.

22 RESPECTFULLY SUBMITTED this 12<sup>th</sup> day of February, 2001

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24   
Scott S. Wakefield  
Chief Counsel, RUCO

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